Tough Love: The Truth About Building Your Company's Value

Jamie D. Watson, CPA
Certified Marketing Consultants (asi/44526)

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Myth: Sales growth is the ultimate measure of how successful my company is.

THE FACTS:

- Sales growth is only part of the financial picture. Also focus on gross margin and adjusted net income and cash flow.
- Work smarter, not harder. More profitable companies need less revenue in order to produce the same profit/return on investment.
- When companies grow too quickly without a stable infrastructure they can end up failing. Be aware of your metrics and understand the role cash flow will play in your growth.
- Big orders, especially one-time orders, aren't always worth the opportunity cost.

TAKEAWAY: While sales growth is one metric to use when growing a company, there are many corresponding and equally important metrics that should be considered.

Myth: The longevity of my company makes it valuable.

THE FACTS:

- Survival/longevity does not directly produce value.
- If your company has been in business for 20 years but has not grown, buyers will question whether your company is scalable or worthy of investment.
- If the business does not keep up with technology/trends the company might actually be worth less.
- Companies need to show upward growth and evolution in order to be seen as valuable.

TAKEAWAY: Mature businesses can be very valuable, but the maturity itself does not contribute to value without a number of other contributing factors – the biggest of which is profitability.

Myth: Untapped potential makes my company more valuable to a buyer.

THE FACTS:

- If a buyer is investing resources (capital, manpower, time, etc.) to develop a sales channel, they want to receive the benefit of the investment.
- If the potential comes to fruition in the form of future sales, there is an opportunity to receive contingency payment over time.
- Why are there are unexplored opportunities?

TAKEAWAY: A seller will not get paid value for sales related to undeveloped opportunities unless they choose to stay on post-sale and participate in future growth.

Myth: I’m a sales and marketing person so I don’t need to understand “the numbers.”

THE FACTS:

- All business owners should have a basic understanding of the numbers. This includes:
    - Sales management – an inside salesperson or VA can assist with detailed tracking.
    - Understanding and monitoring gross margin.
        - What is being captured on the financial statements?
        - Is it in line with expectations/goals?
    - Understanding net income but also CASH FLOW.
        - What projects are coming down the pipeline?
        - Do you need an external source for cash flow (line of credit)?
        - How are your collections on the accounts receivable?

TAKEAWAY: To build a valuable company you have to understand what makes a company valuable which includes knowledge of both the qualitative and quantitative data. Setting up systems that make this routine will help you stay disciplined.

Myth: The best way to attract top sales talent is to pay an above-average commission split.

The FACTS:

- Overpaying salespeople makes your earnings and company value less.
- Overpaying salespeople make it very difficult to sell your company because a buyer has to match the commission scale
- Some of the most profitable companies are paying a salary plus a modest commission.

TAKEAWAY: Your company's relationship with salespeople needs to be based on something other than a cookie-cutter pay structure. Find ways to satisfy your salespeople and bring other types of value to the relationship.

Myth: I have to outbid other distributors to achieve growth targets.

The FACTS:

- If you gain client relationships based on price, you will likely lose them for the same reason.
- Low gross margin makes it nearly impossible to build value in your company. You cannot make up for low margins with more volume.
- Build relationships based on other positive attributes: creativity, customer service, ease of ordering, etc.

TAKEAWAY: Don't chase low-margin business because it's an exciting client or a large order. Find ways to add value and make clients want to work with you.

Myth: One large customer is better than lots of small customers.

The FACTS:

- Large customers create a concentration risk, especially where buyers are concerned.
- One large customer also inherently creates an industry risk.
- All companies should have a strong acquisition strategy in place that constantly generates new leads.

TAKEAWAY: While large customers can be a great way to start a company, owners should continue to diversify by focusing on business growth with other customers in diversified industries.

Myth: Decoration is an easy way to make more in revenue and increase margins.

The FACTS

- Most small distributor owners are excellent salespeople but do not have a background in production or manufacturing.
- Most owners don't adequately capture decoration costs such as additional rent, utilities and wages that make decorating more costly than outsourcing.
- The amount of time it takes to manage the production process decreases the amount of time that can be spent growing the company.
- Staffing the decoration side of the business can be difficult, especially in today's climate.
- Most buyers will not want the decoration equipment if you sell your business.

TAKEAWAY: An adequate and thoughtful analysis must be performed to ensure adding a decorating facility is the right decision.

Myth: I can sell my company and exit immediately without any impact to the value.

The FACTS:

- MOST buyers want the owner to stay involved for a transition period which can be 2-4 years.
- You will most likely maximize the value received if you can align your involvement post transaction with the “earnout” or “contingency payment”.
- A great strategy is to “pretire”, work with your favorite clients, and ease into retirement.
- Sometimes selling the company can take longer than anticipated. Starting the process early allows for more time to find the right buyer.

TAKEAWAY: Plan to sell your company at least two years before you actually want to retire to allow for a smooth transition to the new owner and to maximize value for the company you have built.

Myth: If I have contracts there is no risk or cost to carrying inventory.

The FACTS:

- There is always risk to carrying an asset for another company.
- Buyers will scrutinize any items that are not turning fast enough.
- Direct costs of carrying inventory can be financing charges, additional rent and additional utilities.

TAKEAWAY: It's important to understand the risks of carrying inventory for customers and do the relevant due diligence to protect the company. Keep an eye on metrics and trends as they relate to customer inventory and price accordingly for any overhead.

Myth: I don't need a banking relationship because my company makes money.

The FACTS:

- INCOME and CASH FLOW are two different terms. You can make money without positive cash flow due to slow collection of receivables, investment in equipment, carrying inventory, etc.
- Finance long term assets (equipment, building, etc.) with long term notes.
- Financing short term assets (AR, inventory) with short term debt (line of credit).

TAKEAWAY: Establish and leverage a banking relationship and a line of credit for potential growth opportunities and/or emergencies.

Myth: Tax planning is a waste of money – you pay what you pay.

The FACTS:

- Tax preparation and tax STRATEGY are two different concepts. Which one is your CPA doing?
- Cash vs. Accrual Basis
- Type of entity (Sole Proprietorship, S-Corp, LLC, C-corp, etc.)
- Salary vs. Distributions for owners

TAKEAWAY: A strong and continuous relationship with a good CPA can be valuable. Look for someone who takes a proactive approach to tax STRATEGY, not just tax prep.

Myth: My friend sold his company for 3x multiple so I can use that to value my company.

The FACTS

- “Rules of thumb” are not a good way to get an accurate value of a company.
- Your company is likely one of the most valuable assets you have. It deserves a thoughtful valuation.
- Assumptions about your retirement nest egg are risky.

TAKEAWAY: Don’t estimate your company’s value based on something you heard in the industry. Take a proactive approach to your long-term plan and get an accurate valuation.

Myth: I own a small business so it's not worth having a succession plan.

The FACTS:

- Succession is about the continuity of your company, your employees and your customers.
- If you fail to plan you plan to fail
- A succession plan can include a lot of different aspects, a buy/sell agreement, a transition to a different generation, selling the company to an employee, an ESOP, etc.

TAKEAWAY: Developing a thoughtful succession plan can be valuable for you, your employees and your customers. Don't let your hard work go to waste because of lack of planning.